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June 29, 2009

**Submitted Via E-Mail**

Ms. Jennifer J. Johnson  
Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street & Constitution Ave., NW  
Washington, DC 20551

Re: Capital Adequacy Guidelines: Small Bank Holding Company Policy  
Statement: Treatment of Subordinated Securities Issued to the United  
States Treasury Under the Emergency Economic Stabilization Act of  
2008; 74 Federal Register 26077; June 1, 2009; Docket No. R-1356

Dear Ms. Johnson:

The American Bankers Association (ABA)<sup>1</sup> appreciates the opportunity to comment on the Interim Final Rule published by the Federal Reserve System (Board) to facilitate the timely implementation of the Capital Purchase Program (CPP) for Subchapter S Corp bank holding companies (S-Corp BHCs) and bank holding companies organized in mutual form (Mutual BHCs). We support the Board's adoption of the rule. However, as discussed in more detail below, we request that the final rule clarify that the Tier 1 treatment provided in the rule applies to all securities issued by S-Corp BHCs pursuant to the CPP regardless of when issued.

The rule specifically permits S-Corp BHCs and Mutual BHCs to include the full amount of any new subordinated debt securities (Subordinated Securities) issued to the Treasury under the CPP in Tier 1 capital for purposes of the Board's risk-based and leverage capital guidelines for bank holding companies, provided that the Subordinated Securities count toward the limit on the amount of *other* restricted core capital elements includible in Tier 1 capital. The rule also allows bank holding companies that are subject to the Board's Small Bank Holding Company Policy Statement and are S-Corp or Mutual BHCs to exclude the

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<sup>1</sup>The ABA brings together banks of all sizes and charters into one association. The ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than \$125 million in assets – represent over 95 percent of the industry's \$14 trillion in assets and employ more than two million men and women.

Subordinated Securities from treatment as debt for the purposes of the debt-to-equity standard under this Statement.

The ABA supports the provisions included in this proposal. As the Board has recognized, these Subordinated Securities were intentionally structured similarly to qualifying trust preferred securities that qualify for Tier 1 capital as a restricted core capital element for bank holding companies. Key features include:

- Deep subordination and junior status to depositors and other creditors claims;
- Requirement of a 30 year maturity for Subordinated Securities – the same requirement as junior subordinated notes underlying trust preferred securities;
- The ability of the issuing BHC to defer interest payments; and
- Prohibition on repurchasing equity or trust preferred securities for 10 years following issuance of the Subordinated Securities or increasing common stock dividends for three years, without Treasury’s approval.

Furthermore, the Board requires other safeguards, including its expectation that S-Corp and Mutual BHCs that issue Subordinated Securities will hold capital commensurate with the level and nature of the risks to which they are exposed, and incorporate the Subordinated Securities obligation into liquidity and capital funding plans. These additional features provide additional safeguards, and safety and soundness protection for the Subordinated Securities issued to the U.S. Treasury under the CPP.

The Rule would level the playing field with other CPP participating bank holding companies whose structure allows them to include their CPP investment in Tier 1 capital for purposes of the Board’s risk-based and leverage capital guidelines, and would make participation in the CPP more appealing for S-Corp BHCs and Mutual BHCs. Like the Board’s recent final rule<sup>2</sup> that allows CPP participating bank holding companies that issue senior perpetual preferred stock to Treasury to include such instruments in Tier 1 capital without limit for purposes of the Board’s risk-based and leverage capital guidelines for bank holding companies, the adoption of this rule will be a great benefit for most S-Corp BHCs and Mutual BHCs, even with its requirement to count the Subordinated Securities toward the limit on the amount of other restricted core capital elements includible in Tier 1 capital.

The ABA takes no position on the advisability of participation in the CPP by any given bank. However, we appreciate the Board’s effort in crafting these provisions in furtherance of the CPP’s goal of promoting financial stability by offering capital support to all viable banking organizations regardless of their form of organization.

We urge the Board to clarify one ambiguity raised in the preamble discussion to the rule, where the Board states –

For these reasons and in order to support the participation of S–Corp BHCs in the Capital Purchase Program, promote the stability of banking organizations and the financial system, and help banking organizations meet the credit needs of creditworthy customers,

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<sup>2</sup> 74 *Fed. Reg.* 26081 (June 1, 2009).

the Board has adopted this interim final rule to permit S-Corp BHCs *that issue new Subordinated Securities* to the Treasury under the TARP to include the full amount of such securities in tier 1 capital for purposes of the Board's Capital Guidelines.<sup>3</sup>

The term "new" does not appear in the text of the regulation, and thus it appears that the Board does not intend to distinguish shares issued before publication of the rule from shares issued after. However, the explanatory material quoted above raises a question about whether such a distinction will be applied in practice. We can think of no policy rationale to support the distinction, and thus we urge the Board to clarify that the Tier 1 treatment provided in the rule applies to all securities issued by S-Corp BHCs pursuant to the CPP regardless of when issued.<sup>4</sup> This could be accomplished either by leaving the proposed regulation text unchanged and addressing the issue in the preamble or by amending the regulation text to address this issue directly.

The ABA also supports the Board's proposed revision to the Small Bank Holding Company Policy Statement to specifically allow S-Corp and Mutual BHCs to exclude Subordinated Securities from debt for purposes of the Statement's debt-to-equity ratio standard that would otherwise disallow such organizations' dividend payments. This would remove another potential barrier to small S-Corp and Mutual BHCs from participating in the CPP.

Thank you for considering our comments and recommendations. Please contact Kathleen P. McTighe at (202) 663-5331 or [kmctighe@aba.com](mailto:kmctighe@aba.com) if you have any questions.

Sincerely,



Kathleen P. McTighe

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<sup>3</sup> 74 Fed. Reg. 26077 (June 1, 2009), at 26079. See also *id.*, at 26077.

<sup>4</sup> The United States Government Accountability Office notes that as of June 12, no CPP investments had been made in mutual institutions. See <http://www.gao.gov/new.items/d09658.pdf>, at p. 17. Indeed, the Treasury web site still lacks the standard forms of agreement that Mutual BHCs and mutual banks must execute (see <http://www.financialstability.gov/roadtostability/CPPapdocs.html>). Thus, it appears that the issue of a possible distinction between pre-rule and post-rule CPP investments does not arise in the context of Mutual BHCs. However, if any Mutual BHCs have received investments prior to the issuance of the interim rule, we request that the Board also treat all such investments as Tier 1 capital in accordance with the rule.